BILLING CODE: 6351-01

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 50

RIN 3038-AD60

Swap Transaction Compliance and Implementation Schedule: Clearing Requirement under Section 2(h) of the CEA

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is adopting regulations to establish a schedule to phase in compliance with the clearing requirement under new section 2(h)(1)(A) of the Commodity Exchange Act (CEA or Act), enacted under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The schedule will provide additional time for compliance with this requirement. This additional time is intended to facilitate the transition to the new regulatory regime established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions.

DATES: The rules will become effective [Insert 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

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I. Background

Section 723(a)(3) of the Dodd-Frank Act amended the CEA to provide, under new section 2(h)(1)(A) of the CEA, that it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization (DCO) that is registered under the CEA or a DCO that is exempt from registration under the CEA if the swap is required to be cleared (the Clearing

Requirement).[1] Section 2(h)(2) charges the Commission with the responsibility for determining whether a swap is required to be cleared (a Clearing Requirement determination), through one of two avenues: (1) Pursuant to a Commission-initiated review; or (2) pursuant to a submission from a DCO of each swap, or any group, category, type, or class of swaps that the DCO "plans to accept for clearing."[2] The Commission is proposing its first Clearing Requirement determination concurrently with its adoption of this compliance schedule rule. The finalization of that proposal will trigger the compliance schedule provided for under this adopting release.

On September 20, 2011, the Commission published proposed § 39.5(e)[3] to phase in compliance of the Clearing Requirement upon the Commission's issuance of a Clearing Requirement determination pursuant to § 39.5(b) or (c).[4] That notice of proposed rulemaking (NPRM) also included an implementation schedule for the requirement pursuant to amended section 2(h)(8)(A), which requires a swap subject to the Clearing Requirement to be executed on a designated contract market (DCM) or swap execution facility (SEF), unless no SEF or DCM makes the swap available to trade (the Trade Execution Requirement). The Commission is hereby adopting proposed § 39.5(e), as newly designated § 50.25, to establish a schedule for compliance only for the Clearing

[1] Section 2(h)(7) of the CEA provides an exception to the Clearing Requirement when one of the counterparties to a swap (i) is not a financial entity, (ii) is using the swap to hedge or mitigate commercial risk, and (iii) notifies the Commission how it generally meets its financial obligations associated with entering into a non-cleared swap.

[2] Under section 2(h)(2)(B)(ii), the Commission must consider swaps listed for clearing by a DCO as of the date of enactment of the Dodd-Frank Act.

[3] Commission regulations referred to herein are found at 17 CFR Ch. 1.

[4] See 76 FR 58186 (Sept. 20, 2011).

Requirement. A separate rulemaking will promulgate the final implementation schedule for the Trade Execution Requirement.[5]

The compliance schedule for the Clearing Requirement is based on the type of market participants entering into a swap subject to the Clearing Requirement. The compliance schedule balances several goals. First, the Commission believes that some market participants, such as certain managed accounts, referred to under § 50.25 as "Third-Party Subaccounts," may require additional time to bring their swaps into compliance with the Clearing Requirement. Pursuant to § 39.5(e) (finalized as § 50.25), these market participants would be afforded additional time to clear their swaps so that they will be able to document new client clearing arrangements, connect to market infrastructure such as DCOs, and prepare themselves and their customers for the new regulatory requirements.

Another goal of the compliance schedule is to have adequate representation of market participants involved at the outset of implementing a new regime for requiring certain swaps to be cleared. The Commission believes that having a cross-section of market participants involved at the outset of formulating and designing the rules and infrastructure under which the Clearing Requirement is implemented will best meet the needs of all market participants.

The compliance schedule set forth in § 50.25 defines three categories of market participants: Category 1 Entities,[6] Category 2 Entities,[7] and all other market participants.

[5] The Commission will address the proposed compliance schedules for trading documentation and margining under section 4s of the CEA, 76 FR 58176 (Sept. 20, 2011), at the same time that it finalizes the underlying documentation and margin rules.

As described in § 50.25(b), a swap between two Category 1 Entities must comply with the Clearing Requirement no later than 90 days after the publication of the Clearing Requirement determination in the Federal Register.[8] A swap between a Category 2 Entity and a Category 1 Entity or another Category 2 Entity must comply within 180 days, and all other swaps must be submitted for clearing no later than 270 days after the Clearing Requirement determination is published in the Federal Register. To clarify, the swap is subject to the latest compliance date for one of the counterparties. In other words, if a Category 1 Entity enters into a swap with a Category 2 Entity, both parties have 180 days to submit the swap for clearing. However, the counterparty entitled to the later compliance date may elect to clear the swap earlier, and in that event, its counterparty is required to oblige.

II. Comments on the Notices of Proposed Rulemaking

The Commission received 26 comments during the six-week public comment period following publication of the NPRM. The Commission considered each of these comments in formulating the final regulation, § 39.5(e) (finalized as § 50.25).

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[6] A Category 1 Entity is defined under § 50.25(a) to include a swap dealer; security-based swap dealer; major swap participant; major security-based swap participant; or active fund (also defined by § 50.25(a)).

[7] A Category 2 Entity is defined under § 50.25(a) to include a commodity pool; a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 other than an active fund; or a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956, provided that, in each case, the entity is not a Third-Party Subaccount. As proposed, this category contained employee benefit plans under the Employee Retirement Income and Security Act of 1974, but under the final rule, these plans will not be included in Category 2. See below for further discussion.

[8] As proposed, the rule required compliance within 90, 180, or 270 days after the effective date set by the Commission for a Clearing Requirement determination. In order to clarify precisely when the compliance period will commence, the Commission has modified the rule to indicate that the compliance periods begin as of the date of publication of final Clearing Requirement determination rules in the Federal Register. From this point, market participants have either 90, 180, or 270 days to come into compliance.

A. Comment Period

The Commission published the NPRM in the Federal Register on September 20, 2011, and the public comment period closed on November 4, 2011.

Financial Services Roundtable (FSR) comments that the public should be able to comment on an implementation schedule for each swap subject to the Clearing Requirement because the characteristics of one particular swap may necessitate a very different schedule from another.

Pursuant to § 39.5(b)(5) in the case of swap submissions and § 39.5(c)(2) in the case of Commission-initiated reviews, the public will have an opportunity to comment on each of the Commission's proposed Clearing Requirement determinations, and to comment on whether the Commission should employ the compliance schedule for that determination. In this manner, the public will have an opportunity to comment on whether use of the compliance schedule is appropriate for a given Clearing Requirement determination covering particular swaps.

B. Harmonization

The NPRM reflects consultation with the staff of the Securities and Exchange Commission (SEC), prudential regulators, and international regulatory authorities. With respect to the latter, the Commission is mindful of the benefits of harmonizing its regulatory framework with that of its counterparts in foreign countries. The Commission therefore has monitored global advisory, legislative, and regulatory proposals, and has consulted with foreign regulators in developing the final regulations.

Vanguard, the Federal Home Loan Banks (FHLBs), and the Investment Company Institute (ICI) each recommend that the Commission coordinate the compliance schedule

for the Clearing Requirement, as well as implementation schedules concerning other Dodd-Frank Act requirements, with the SEC, the prudential regulators, and international regulators to avoid market disruption and avoid regulatory arbitrage. The American Council of Life Insurers (ACLI) urges the Commission to coordinate with the SEC and international regulators to achieve reductions in compliance costs. A joint letter by the Futures Industry Association, the International Swaps and Derivatives Association, and the Securities Industry and Financial Markets Association (FIA/ISDA/SIFMA) urges the Commission to coordinate implementation schedules with those introduced by the SEC, the National Futures Association, self-regulatory organizations, and market infrastructure providers.

In addition to the regulators referenced above, the Commission has consulted with other U.S. financial regulators including: (1) the Board of Governors of the Federal Reserve System; (2) the Office of the Comptroller of the Currency; and (3) the Federal Deposit Insurance Corporation. Staff from each of these agencies has had the opportunity to provide oral and/or written comments to this adopting release, as well as to the proposal.

C. Cross-Border and Affiliate Transactions

The NPRM did not differentiate between domestic and foreign swap dealers (SDs), major swap participants (MSPs) or their counterparties, and did not address affiliate transactions.

MarkitSERV and the Alternative Investment Management Association (AIMA) each comment that the NPRM, as well as other proposals setting forth implementation schedules for complying with Dodd-Frank Act requirements, should clarify the status of

cross-border transactions. Better Markets states that trading relationships between an SD or MSP and its affiliate or an international counterparty should not be treated any differently than any other trading relationship. FIA/ISDA/SIFMA comments that the Commission should publish guidance concerning the extraterritorial application of Title VII prior to the commencement of any implementation schedule.

The Commission separately has issued guidance on the cross-border application of Title VII, including the Clearing Requirement.[9] With regard to inter-affiliate transactions, the Commission will be considering this issue in an upcoming proposal.

D. Comprehensive Implementation Schedule

This adopting release pertains exclusively to the implementation of the Clearing Requirement.

The Coalition for Derivatives End-Users (CDE), a joint letter by the Edison Electric Institute, the National Rural Electric Cooperative Association, and the Electric Power Supply Association (Joint Associations); ICI; and MarkitSERV each argue that the Commission should create an implementation plan addressing all of its final Dodd-Frank rules and that the Clearing Requirement compliance schedule should be part of that comprehensive schedule. CDE comments further that a comprehensive schedule is important to end-users, particularly in the areas of recordkeeping and reporting. The Joint Associations also comment that a comprehensive schedule should detail compliance dates, both specific and market-wide, for each registered entity and that the Commission should request further comment on this subject as more final rules are published.

[9] See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 FR 41213 (July 12, 2012).

Vanguard comments that in implementing Title VII, the Commission should focus first on systemic risk issues and then issues relating to transparency and trade practices. Implementation schedules should be organized by type of participant and asset class. The schedules should also allow for voluntary compliance.

ACLI argues that the Commission has not provided sufficient guidance concerning new rules and effective dates in order for market participants to conduct a prudent review of resource planning. ACLI maintains that complying with only some rules creates a risk that documents will have to be renegotiated when other rules are phased in.

In this adopting release, the Commission is focused on providing additional time to market participants that may require more time to comply with one of the key elements of the Dodd-Frank Act – the Clearing Requirement. The compliance schedule that is the subject of this adopting release was proposed at the same time as three other compliance schedules – schedules for the Trade Execution Requirement and two important requirements under section 4s of the CEA, documentation and margin for uncleared swaps. Each of these proposed compliance schedules responded to particular concerns from market participants, especially those that are not required to register with the Commission. The Commission also has published compliance dates for phasing in implementation in nearly all of its final rules.[10] In addition, the Commission has twice

[10] See, e.g., Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136, 2195-2196 (Jan. 13, 2012); Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734, 9803 (Feb. 17, 2012); and Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334, 69408 (Nov. 8, 2011).

published on its website general schedules regarding the sequence and timing for its own consideration of final rules.[11]

In response to ACLI, as discussed further below, the Commission has finalized all the documentation requirements necessary for compliance with the Clearing Requirement.[12] With regard to Vanguard's comment, the Commission intends to implement the Clearing Requirement based on specific classes of swaps, beginning with those asset classes that are currently being cleared. The Commission believes that implementation of the Clearing Requirement will serve to reduce systemic risk by mitigating counterparty credit risk through the use of the marking-to-market, margining, and risk mutualization provided by central counterparties. The adoption of this compliance schedule is an important step toward implementing that requirement. In addition, the compliance schedule expressly allows for voluntary clearing prior to the required compliance date, and market participants currently are free to clear all swaps offered for clearing by DCOs on a voluntary basis.

E. Prerequisite Rules

The preamble to the NPRM stated that prior to requiring compliance with any Clearing Requirement determination, the Commission must publish the following final rules: Definitions of swap, SD, and MSP; End-User Exception to Mandatory Clearing of Swaps; and Protection of Cleared Swaps Customer Collateral.

The FHLBs comment that the rule text of an implementation rule should state that the compliance schedule will not take effect until the Commission has published

[11] See http://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm.

[12] See Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278 (April 9, 2012).

applicable final rules. The FHLBs believe that it is insufficient for the preamble to make this point.

The Joint Associations state that they cannot comment on the adequacy of either the compliance schedule for the Clearing Requirement or other implementation schedules until various final rules have been published, including the definitions of swap, SD, and MSP. The Joint Associations want to see how many of their comments to these rules have been adopted because this will affect how long it will take their members to comply with Title VII requirements. ICI comments that parties cannot prepare for centralized clearing until the Commission publishes the final rule concerning the definition of swap.

Citadel, FHLBs, and FIA/ISDA/SIFMA each recommend that the Commission publish final rules related to clearing, such as customer clearing documentation, timing of acceptance for clearing, and clearing member risk management, prior to phasing in the Clearing Requirement. FHLBs state that the prior publication of the Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management rules is important so that market participants can fully appreciate risks and not have to renegotiate documentation.

The Committee on Investment of Employee Benefit Assets (CIEBA) recommends that the Commission not impose the Clearing Requirement until full physical segregation is available for margin of cleared swaps. CIEBA also comments that if the Commission publishes final segregation rules for cleared swaps customer collateral at the same time that it phases in the Clearing Requirement, then market participants' limited resources would be overwhelmed. ICI comments that parties cannot prepare for centralized clearing until the Commission publishes the final rule concerning the Protection of

Cleared Swaps Customer Collateral. ICI also argues that the documentation requirements under section 4s(i) of the CEA must be finalized before market participants are required to comply with mandatory clearing.

CME recommends that the Commission finalize the DCO Conflicts of Interest rules prior to requiring compliance with the Clearing Requirement.

The American Bankers Association (ABA) believes that end-user banks not be required to comply with the Clearing Requirement until 180 days after the Commission determines whether end-user banks will be exempt from the Clearing Requirement.

AIMA believes the Commission should publish final rules concerning the Margin Requirement, as well as customer collateral protection rules, prior to phasing in the Clearing Requirement.

The Commission has finalized all four of the rules identified in the NPRM that it needed to be completed prior to requiring compliance with the Clearing Requirement (namely, the End-User Exception to Mandatory Clearing of Swaps;[13] Protection of Cleared Swaps Customer Collateral;[14] the Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant";[15] and the Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps;

[13] End-User Exception to the Clearing Requirement for Swaps, adopted by the Commission on July 10, 2012, available at www.cftc.gov.

[14] Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 (Feb. 7, 2012).

[15] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596 (May 23, 2012).

Security-Based Swap Agreement Recordkeeping).[16] In addition, the Commission has finalized rules related to Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management.[17] Finalizing these rules addresses the FHLBs' concerns about having to revise documentation more than once and provides certainty as to swap processing requirements and expectations regarding risk management for clearing members. On the other hand, in response to CME's comment, the Commission does not believe it is necessary for final DCO Conflicts of Interest rules to be in effect before requiring compliance with the Clearing Requirement because these rules do not relate directly to the clearing process, customer connectivity, clearinghouse risk management, or other matters that would affect the implementation of the Clearing Requirement.

In response to the FHLBs' request that the implementation rule text include a provision that the rule is not effective until the definitions of SD, MSP, and swap are finalized, the Commission reiterates that all of the pre-requisite rules for the Clearing Requirement have been adopted. With regard to CIEBA's comment about full physical segregation, the Commission published its final rule concerning Protection of Cleared Swaps Customer Collateral on February 7, 2012.[18] In that rulemaking, the Commission indicated that it may address issues related to collateral held in third-party safekeeping accounts at some point in the future. However, given that a fully operational segregation

[16] Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Section VII, adopted by the Commission on July 10, 2012, available at www.cftc.gov.

[17] Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278, (April. 9, 2012).

[18] 77 FR 6336 (Feb. 7, 2012).

regime is required to be in place by November 8, 2012, the Commission does not believe that it is necessary for this additional matter to be resolved prior to requiring compliance with the Clearing Requirement.

In response to ICI's comment, the Commission clarifies that finalization of the swap trading relationship documentation requirements for SDs and MSPs under section 4s(i) of the CEA is not required for compliance with the Clearing Requirement because the documentation that is the subject of those rules relates primarily to bilaterally-executed, uncleared swap transactions, and none of the provisions in proposed § 23.504 pertain directly to the Clearing Requirement. Similarly, in response to AIMA's comment, final margin rules for uncleared swaps are not required to be finalized prior to requiring compliance with the Clearing Requirement as these are related, but distinct, provisions under the Dodd-Frank Act.

F. Definitions

Under § 39.5(e)(1), the Commission proposed definitions of the terms "Category 1 Entity," "Category 2 Entity," "Active Fund," and "Third-Party Subaccount." The definitions set forth in proposed § 39.5(e) (now § 50.25) would apply specifically to provisions contained in part 39 (now part 50) and only those other rules that explicitly cross-reference these definitions. The Commission is adopting the definitions as proposed, with the exceptions discussed below.

1. Active Fund

As proposed under § 39.5(e)(1), ''any private fund as defined in section 202(a) of the Investment Advisers Act of 1940, that is not a third-party subaccount and that

executes 20 or more swaps per month" would be defined as an "Active Fund" and subject to the shortest implementation schedule for compliance with the Clearing Requirement.

Numerous commenters, such as Better Markets, Chris Barnard, and AIMA, agree with the Commission that using a market participant's average monthly trading volume would be an appropriate proxy for determining an entity's ability to comply with the Clearing Requirement and would be better than a proxy based on notional volume or open interest. AIMA agrees with the NPRM's proposal that Active Funds be subject to the 90-day deadline.

Other commenters express concerns about solely relying on monthly volumes as a proxy, especially without further defining the types of swaps that would be included in the calculation. ACLI states that the frequency of trading is not an appropriate indicator of a market participant's experience or resources. The Association of Institutional Investors (AII) states that the definition should specify the type of swaps that count towards the threshold. CDE recommends a minimum average monthly notional threshold to avoid capturing smaller end-users. CDE also states that hedges and inter-affiliate swaps should be excluded from this monthly average threshold. Managed Funds Association (MFA) similarly requests clarification regarding those swaps that would be included in the monthly swap calculation. Specifically, MFA requests clarification as to whether novations, amendments, or partial tear-ups would be included.

Commenters also focus on the average monthly threshold of 20 swaps per month for the preceding 12 months. FIA/ISDA/SIFMA proposes that the threshold be an average of 200 trades per month. Vanguard proposes a similar threshold. Both AII and MFA think the proposed threshold was overly inclusive. MFA also highlights its belief

that the proposed definition would be difficult to administer, while unnecessarily creating another tier of market participants for the purposes of the implementation schedules.

In response to these comments, the Commission is increasing the average monthly threshold to 200 swap trades per month for the preceding 12 months. The Commission believes that monthly trading volume is a suitable proxy for determining the appropriate implementation schedule for a swap counterparty. By increasing the threshold to 200, as recommended by FIA/ISDA/SIFMA, as well as Vanguard, the risk of capturing smaller, less experienced swap counterparties should be substantially diminished. The market participants engaging in this level of swap activity should be able to access the resources necessary to meet the 90-day implementation schedule. In light of the number of transactions currently being cleared on a voluntary basis by funds, the Commission does not believe that an increase in the threshold of monthly swap trades will negatively impact the goal of broad market participation in the implementation of the Clearing Requirement. The Commission believes this increase in the average monthly threshold also addresses CDE's concerns about smaller market participants using swaps only to hedge risk.

Further, by maintaining the concept of Active Fund, the Commission believes that it will continue to ensure adequate representation across the spectrum of market participants during the first phase of the implementation of the Clearing Requirement. As a result of this participation, processes and infrastructure will be established to serve all segments of the market, not just SDs and MSPs, which are included in the initial phase of the compliance schedule for the Clearing Requirement.

In response to AII and MFA, the Commission clarifies that the average monthly threshold of swaps applies to new swaps that the entity enters into, and it does not apply to novations, amendments, or partial tear-ups. In addition, the Commission clarifies that the 200 swap threshold includes any swap, as defined under the CEA and § 1.3, and not just those swaps that would be subject to the relevant Clearing Requirement determination and attendant compliance schedule.

2. Third-Party Subaccount

Under § 39.5(e) (finalized herein as § 50.25), Third-Party Subaccounts are excluded from the definitions of Category 1 Entity and Category 2 Entity, with the effect that such subaccounts will have 270 days, the longest period, in which to comply with the Clearing Requirement. The NPRM defined Third-Party Subaccounts as "a managed account that requires the specific approval by the beneficial owner of the account to execute documentation necessary for executing, confirming, margining, or clearing swaps." The purpose of excluding Third-Party Subaccounts from the defined categories was to ensure that investment managers, who may be faced with bringing numerous accounts into compliance, would have adequate time to do so.

Commenters question whether the definition was broad enough to provide sufficient time for Third-Party Subaccounts to comply with the Clearing Requirement. ICI noted that Third-Party Subaccounts, whether subject to the specific execution authority of the beneficiary or not, require managers to work closely with clients when entering into trading agreements on the customer's behalf. As such, ICI feels that no distinction should be made based on specific execution authority or lack thereof. ICI comments that all Third-Party Accounts should be uniformly classified and be given 270

days to comply. AII similarly states that the definition is too narrow given the administrative work required to manage an account, regardless of the execution authority. Further, AII states that execution authority is not an industry standard. The term, as proposed, therefore divides the universe of managed accounts inappropriately. FIA/ISDA/SIFMA recommends that all accounts managed by third parties, regardless of the execution authority, should be given the most time to comply with the Clearing Requirement.

Based on the comments received, the Commission is revising the definition of Third-Party Subaccount to mean "an account that is managed by an investment manager that (1) is independent of and unaffiliated with the account's beneficial owner or sponsor, and (2) is responsible for the documentation necessary for the account's beneficial owner to clear swaps." In modifying this definition, the Commission is taking into account the point made by AII, FIA/ISDA/SIFMA, and ICI that all investment managers will need additional time to comply with a Clearing Requirement regardless of whether they have explicit execution authority. However, the definition retains the nexus between the investment manager and the documentation needed for clearing swaps. In other words, if the investment manager has no responsibility for documenting the clearing arrangements, then that account would be required to clear its swaps subject to required clearing within 180 days. For those accounts under the revised definition, however, the Commission believes that the 270-day deadline is more appropriate. Given the general notice investment managers have had about the Dodd-Frank Act's Clearing Requirement since the enactment of the statute in July, 2010, managers should have been able to consider and plan the infrastructure and resources that are necessary for all of their accounts,

including Third-Party Subaccounts, to comply with the Clearing Requirement. Thus, the 180- and 270-day deadlines should provide adequate time to accommodate all managed accounts.

3. Category 1 and Category 2 Entities

The compliance schedule is organized according to the type of market participant. To the extent that the Commission determines that a compliance schedule is warranted in connection with a Clearing Requirement determination (i.e. to comply with the Clearing Requirement) a market participant defined as a Category 1 Entity will have 90 days to comply, a Category 2 Entity will have 180 days, and all others will have 270 days. According to the proposed definitions, a Category 1 Entity includes an SD, a security-based swap dealer, an MSP, a major security-based swap participant, or an Active Fund. A Category 2 Entity includes a commodity pool, a private fund, as defined by the Investment Advisers Act of 1940, an ERISA plan, or a person predominantly engaged in banking or other financial activities, as defined by section 4(k) of the Bank Holding Company Act. A Category 2 Entity would not include an Active Fund or a Third-Party Subaccount.

Encana Marketing (USA) Inc. (Encana) and the Joint Associations comment that non-financial end users should be expressly included in the category with the longest timeframe. CDE argues that financial end-users should be treated identically to non-financial end-users because they do not pose systemic risk, and, therefore, should be given the most time to comply with the Clearing Requirement, and not included in Category 2. ICI seeks clarification that a market participant can determine whether it is an MSP for purposes of the compliance schedule for the Clearing Requirement at the

same time that it is required to review its status as an MSP under other Commission and SEC rules.

CIEBA states that in-house ERISA funds should be in the group with the longest compliance time, and not Category 2 Entities. CIEBA notes that such funds do not pose systemic risk, and they typically rely upon third-party managers for some portion of their fund management. Splitting in-house and external accounts (i.e. those accounts meeting definition of Third-Party Subaccount and permitted 270 days) of the same ERISA plan will impact risk management given different implementation schedules. CIEBA also states that this distinction will cause pension funds to bear the costs of compliance because they will need to comply prior to their third-party managers, who would be better positioned to provide insight and service in this regard.

The Commission believes that the definitions of Category 1 Entity should be finalized as proposed, but that the definition of Category 2 Entity should be modified by removing the reference to ERISA plans. In response to Encana and the Joint Associations, non-financial end users are adequately addressed in § 39.5(e)(2)(iii) (now § 50.25(b)(3)) – unless the swap transactions are eligible to claim the exception from the Clearing Requirement under section 2(h)(7) of the CEA, the parties are given 270 days to comply with the Clearing Requirement. With respect to issues raised by CDE regarding those financial entities included in Category 2, based on numerous meetings with participants in the swap market, the Commission believes that financial entities are capable of complying with the Clearing Requirement 90 days sooner than non-financial entities. Accordingly, the compliance schedule has correctly situated Category 2 Entities based upon their ability to meet the requirements of the underlying regulations.

Moreover, the distinction between financial and non-financial entities has a statutory basis in section 2(h)(7) of the CEA.

The Commission recognizes the concerns raised by CIEBA regarding splitting in-house and external accounts (i.e., those accounts meeting the definition of Third-Party Subaccount and permitted 270 days) of the same ERISA plan. In response to these concerns, the Commission is removing the reference to employee benefit plans as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974. As a result, these ERISA plans will be afforded the longest compliance period (270 days).

With regard to ICI's comment, a potential MSP can review its obligation to register as an MSP at the same time it is reviewing where it fits under the Clearing Requirement compliance schedule. In many instances, MSPs will have to review their registration obligations ahead of complying with the Clearing Requirement. However, if an entity discovers that it has crossed the threshold established under the MSP rules and is required to register during the 90-day period for Category 1 Entities, the Commission would consider allowing that entity to petition for additional time to come into compliance with the Clearing Requirement.[19]

G. Compliance Schedule for the Clearing Requirement

As mentioned above, § 39.5(e)(2) provides that when the Commission determines that an implementation schedule is appropriate in connection with a given Clearing Requirement determination, market participants within the definition of Category 1 will

[19] Similarly, the Commission would consider allowing entities to petition for additional time to comply to the extent that they discover that they have exceeded the de minimis threshold under the swap dealer definition and are required to register during the 90-day period for Category 1.

have 90 days to comply, those within the definition of Category 2 will have 180 days, and all others 270 days to implement the Clearing Requirement.

4. Application to All Swap Types

The Clearing Requirement compliance schedule is based upon the nature of a given swap market participant, considering the participant's risk profile, compliance burden, resources, and expertise. The schedule does not contemplate different implementation timeframes based upon the characteristics of particular swaps.

AIMA states that it does not believe further implementation schedules are necessary based on the nature of the swap itself. Better Markets, Citadel, and MFA comment that the compliance schedule should apply, however, to all swaps within a "group" or "class," as defined by the Commission's Clearing Requirement determination.

Commenters such as CDE state that the Commission should publish an implementation schedule specific to the characteristics of a particular type of swap. CDE comments that because it is unlikely that end-users, and other entities relied upon by end-users, will be able to meet the requirements necessary to comply with clearing determinations for all swap products at the same time, the Commission should phase in implementation deadlines by swap type, according to the amount of systemic risk posed by a particular swap.

MarkitSERV asserts that all Dodd-Frank Act requirements should be phased-in by asset class, taking into account that different asset classes have various levels of product standardization, electronification, volumes, and types of counterparties. FIA/ISDA/SIFMA also states that there should be a separate compliance schedule for each asset class. FIA/ISDA/SIFMA also states that the Commission should require credit

default swaps and interest rate swaps to be cleared first because those products are already being cleared. Commodity and equity swaps, according to FIA/ISDA/SIFMA, should be required to be cleared later because the marketplace is currently clearing fewer of those products.

AIMA, CDE, ICI, and MarkitSERV state that the compliance schedule should require the Commission to phase in each Clearing Requirement determination as set forth in § 39.5(e). FHLB and ICI comment that the Commission should have the flexibility to extend clearing implementation dates, but not shorten them. Citadel counters that the compliance schedule should only be triggered when a determination is issued for a new category of swaps.

This rule affords the Commission discretion to determine whether to apply the compliance schedule in connection with a particular Clearing Requirement determination. The Commission agrees that while the schedule may be necessary in connection with some Clearing Requirement determinations, especially those covering new classes of swaps, there also may be determinations that are sufficiently similar to prior ones that no compliance schedule is necessary. As such, the Commission will determine whether or not to apply the § 39.5(e) (now § 50.25) compliance schedule as part of its analysis in connection with each Clearing Requirement determination.

Further, it remains the Commission's intention that those swaps currently being cleared will be subject to the first Clearing Requirement determinations. As a result, market participants initially will comply with the Clearing Requirement using established platforms and technology. This should limit a market participant's burden in transitioning to clearing, as the use of existing infrastructure will mean less time and

expense necessary to develop independent programs, technology, or platforms to clear such transactions.

5. Timing of Implementation Schedules

Citadel and Better Markets comment that they agree with the proposed compliance schedule because market participants have had notice of the movement towards clearing for one to three years, and the clearing infrastructure already exists with regard to interest rate and credit default swap products. Citadel and Tradeweb believe the proposed schedule correctly staggers compliance according to category of market participant. Citadel does not support extending the 270-day timeframe because 270 days would grant sufficient time to market participants without providing so much time as to engender a material, competitive advantage or regulatory arbitrage. AIMA believes the proposed schedule grants sufficient time to each category of market participant so that they will be able to comply with the Clearing Requirement. Similarly, the Joint Associations and The Westpac Group (Westpac) generally agree with phasing in implementation with the Clearing Requirement according to category of participant.

CIEBA states that because SDs, MSPs, and Active Funds will be the first focus for all third party vendors, ERISA plans will be competing for these resources only after the first implementation deadline has passed, leaving only 90 days for a crowded market place to comply. With limited resources, such a tight timeframe may lead to inadequate agreements and/or increased risk exposure. Further, inadequate agreements caused by lack of resources and rushed documentation will create even further cost disparity for clearing between U.S. pension plans and European ones that will not be required to clear swaps. As such, CIEBA recommends that Category 2 Entities have more than 180 days

to comply. Likewise, FIA/ISDA/SIFMA note that the compliance schedule should be lengthened and that buy-side entities, which may currently be categorized as Category 1 Entities, should not be required to commence clearing until the second quarter of 2013 at the earliest.

CDE argues that SDs and MSPs should comply before establishing other end-user deadlines. CDE believes that if Category 1 Entities cannot comply, then that will compound problems for Category 2 and 3 Entities. If an implementation schedule must be set, the CDE recommends one year for end-users, in light of their limited internal resources and the competition for external resources.

ACLI comments that complex issues will surface as market participants try to combine the agency framework presently existing in the futures markets (i.e., customer-futures commission merchant) with the principal-to-principal framework that has existed in the over-the-counter swaps market. In addition to executing the necessary agreements, insurers will want to ensure they enter into agreements with parties that serve them best. The combination of these factors means that timeframes are too short and may result in smaller firms accepting unfavorable agreements with fewer counterparties, possibly concentrating risk. ACLI also highlights that insurers face an additional burden in ensuring that compliance with the Clearing Requirement is consistent with their state regulatory obligations.

Vanguard argues that additional time will be required to enter into the new agreements necessitated by the move to a cleared derivatives market. Vanguard highlights the large volume of such agreements and the lack of market standards. ICI also finds the compliance schedule to be too short in light of the needs to build and test

new systems, adapt to new regulatory requirements, and educate customers about these changes.

Mastercard Worldwide urges the Commission to give non-bank firms at least 270 days to comply with the Clearing Requirement in respect of their foreign currency hedging activities, even if the firm is covered by section 4(k) of the Bank Holding Company Act. Westpac comments that Category 1 Entities should have at least 180 days to comply with the Clearing Requirement, noting that not all SDs, particularly smaller ones, are currently DCO members. Regional Banks also request that small SDs have at least 180 days to comply with the Clearing Requirement in light of their relative lack of resources and experience, as compared to larger SDs.

ACLI and FSR believe that the compliance schedule for the respective entity categories should run consecutively rather than concurrently. For example, the 180 days given to Category 2 Entities to comply with the Clearing Requirement should begin only after the expiration of the 90 days given to Category 1 Entities.

FSR does not believe there are sufficient resources, either internally, at market participants, or externally, at third party vendors, for the compliance schedule to run concurrently. If the schedule were to run concurrently, then resources would be allocated sequentially to the detriment of entities in the later implementation groups. ACLI, Joint Associations, and the Coalition of Physical Energy Companies (COPE) each express concern that the proposed compliance schedule does not provide sufficient time for the software companies and other vendors, upon which many smaller market participants rely, to develop, test, and debug the software and other technology that will be needed to ensure compliance with the Clearing Requirement. The Joint Associations and COPE

each suggests the Commission take affirmative steps to solicit feedback from these software makers, particularly from vendors that provide "position and trade capture software," in order to determine the amount of time market participants will need to implement software necessary to comply with the Clearing Requirement.

The Commission is finalizing the compliance schedule for the Clearing Requirement as proposed, except for the changes described above for ERISA plans and Third-Party Subaccounts. The Commission believes that the 90-, 180-, and 270-day implementation periods will give market participants sufficient time to comply with the Clearing Requirement. The Commission agrees with commenters such as Citadel and Better Markets that the move to required clearing has been proceeding for two years under the Dodd-Frank Act. This period should have allowed parties to contemplate and design implementation plans and to identify the resources needed to execute those plans. With the Commission's decision to focus on those swaps that are currently cleared when considering its initial Clearing Requirement determinations, market participants will be working with clearing offerings that are seasoned and established, justifying the timeframes provided for in the compliance schedule. For these reasons, the Commission also declines to change the concurrent nature of the compliance schedule.

Given the final rules for the definitions of swap dealers, and the threshold used in terms of annual notional volume of swaps for such swap dealers, the Commission does not believe it necessary to further distinguish between larger swap dealers and smaller ones for purposes of the implementation periods related to Clearing Requirements.[20]

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[20] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596, (May 23, 2012).

Similarly, the Commission does not believe it practicable to make distinctions between entities covered by section 4(k) of the Bank Holding Company Act for the purpose of establishing a 180-day implementation period as compared to a 270-day period.

In response to CDE, the Commission also notes that certain swaps would not be subject to the Clearing Requirement under section 2(h)(7) of the CEA when one of the counterparties to a swap (i) is not a financial entity, (ii) is using the swap to hedge or mitigate commercial risk, and (iii) notifies the Commission how it generally meets its financial obligations associated with entering into a non-cleared swap. If a market participant can claim an exemption, the Clearing Requirement will not be applicable. In all other cases, the implementation schedule for a Clearing Requirement would provide for up to 180- or 270- days for such market participants.

In response to concerns that state regulatory obligations for insurance companies might create obstacles to compliance with implementation schedules as suggested by ACLI, the Commission observes that those insurers would have a minimum of six months to work with their state regulators to address the matter. If no solution could be found within that time period, an affected insurer would be able to petition the Commission for specific relief.

The Commission also has taken affirmative steps to ensure that external providers of services to derivative market participants, such as derivatives software providers, have been included in the dialogue concerning implementation scheduling. At the May 2011 Implementation Roundtable, these vendors voiced their opinions with respect to how an implementation schedule could provide sufficient time for market participants relying on "off-the-shelf" derivatives tracking software to deploy such software such that they could

comply with the Clearing Requirement. The Commission will continue to develop its understanding of technology issues and will solicit comment on this issue in forthcoming proposed Clearing Requirement determinations.

III. Cost-Benefit Considerations

A. Pre-Dodd-Frank Context

Prior to the enactment of the Dodd-Frank Act,[21] swaps were not subject to required clearing. However, the limited market data that is available suggests that over-the-counter (OTC) swap markets have been migrating into clearing over the last few years in response to natural market incentives as well as in anticipation of the Dodd-Frank Act's clearing requirement. LCH.Clearnet data, for example, shows that the outstanding volume of interest rate swaps cleared by LCH has grown steadily since at least November 2007, as has the monthly registration of new trade sides. Together, those facts indicate increased demand for LCH clearing services related to interest rate swaps, a portion of which preceded the Dodd-Frank Act.[22] Data available through CME and TriOptima indicate similar patterns of growing demand for interest rate swap clearing services, though their publicly available data does not provide a picture of demand prior to the passage of the Dodd-Frank Act in July 2010.[23] The trend toward increased clearing of swaps is likely to continue as the Commission begins determining that certain swaps are required to be cleared (Clearing Requirement determination). In fact, the Tabb Group

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[21] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[22] See http://www.lchclearnet.com/swaps/volumes/.

[23] See http://www.cmegroup.com/trading/interest-rates/cleared-otc/index.html#data and http://www.trioptima.com/repository/historical-reports.html.

estimates that 60-80% of the swaps market measured by notional amount will be cleared within five years of the time that the Dodd-Frank Act is implemented.[24]

B. Dodd-Frank Act section 723(a)(3)

In the wake of the financial crisis of 2008, Congress determined, among other things, that swaps shall be cleared upon Commission determination. Specifically, section 723(a)(3) of the Dodd-Frank Act amended section 2(h)(1)(A) of the CEA to make it "unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under this Act or a derivatives clearing organization that is exempt from registration under this Act if the swap is required to be cleared."[25] The statutory swap clearing requirement is designed to standardize and reduce counterparty risk associated with swaps, and, in turn, mitigate the potential systemic impact of such risks and reduce the likelihood for swaps to cause or exacerbate instability in the financial system.[26] It reflects a fundamental premise of the Dodd-Frank Act: the use of properly functioning central clearing can reduce systemic risk.

C. Final Rule

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[24] See Tabb Group, "Technology and Financial Reform: Data, Derivatives and Decision Making."

[25] Section 2(h)(2) of the CEA charges the Commission with responsibility for determining whether a swap is required to be cleared (a Clearing Requirement determination).

[26] When a bilateral swap is moved into clearing, the clearinghouse becomes the counterparty to each of the original participants in the swap. This standardizes counterparty risk for the original swap participants in that they each bear the same risk attributable to facing the clearinghouse as counterparty. In addition, clearing mitigates counterparty risk to the extent that the clearinghouse is a more creditworthy counterparty relative to those that each participant in the trade might have otherwise faced. This is because a clearinghouse benefits from netting with counterparties and may compel counterparties to post additional initial margin as collateral or force them to reduce their outstanding positions when markets move against them. Clearinghouses have demonstrated resilience in the face of past market stress. Most recently, they remained financially sound and effectively settled positions in the midst of turbulent events in 2007-2008 that threatened the financial health and stability of many other types of entities.

The rule contained in this adopting release addresses one aspect of required swap clearing under section 2(h) of the CEA: implementation scheduling following a Commission determination that a class of swaps is required to be cleared. In other words, is immediate clearing required or is implementation subject to some delay. On September 20, 2011, the Commission published a NPRM.[27] The Commission proposed a phased-in compliance schedule for swaps subject to Clearing Requirement determinations that distinguishes among Category 1 Entities, Category 2 Entities, and all other entities (referred to for purposes of this section III as "Category 3 Entities"); those entities, respectively, would have 90 days, 180 days, and 270 days, from the date of the Clearing Requirement determination to comply with the Clearing Requirement.[28] The NPRM also requested comment with respect to the costs and benefits of the proposed schedule, including, specifically, data, assumptions, calculations, or other information to quantify its costs and benefits, as well as alternatives to it. The Commission received 26 comment letters in response, none of which provided quantitative analysis regarding the costs or benefits of the proposed compliance schedule.[29]

These comments touch upon a variety of issues, and include a number that supported the Commission's approach as proposed. Others note certain areas of concern about costs or benefits under the rule as proposed, and either expressly propose alternatives or raise issues that have caused the Commission to consider alternatives to it.

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[27] See 76 FR 58186.

[28] The schedule contained in the NPRM , like the one contained in this adopting release, can be used at the option of the Commission when issuing Clearing Requirement determinations.

[29] ACLI provides an estimate for one member's information technology and legal costs to comply with all Title VII requirements. The estimate does not include any calculations and does not separate out any costs they believe are directly attributable to this rule.

Among other things, commenters responded to the phased approach, the entities included in Category 1, Category 2, and Category 3, the amount of time that the schedule provides for entities in each category, and the optionality of the schedule.

In the absence of this rule, market participants would be required to comply with the Clearing Requirement immediately upon issuance of a Clearing Requirement determination by the Commission. Pursuant to the rule, however, when the Commission deems it appropriate, market participants will be provided additional time as prescribed in the rule's schedule to comply with Clearing Requirement determinations. Category 1 entities, which include, among others, SDs, MSPs, and Active Funds,[30] will have 90 days from the date that a Clearing Requirement determination is published in the Federal Register to comply. Category 2 Entities, which include commodity pools; private funds as defined by the Investment Advisers Act of 1940, other than Active Funds; and banks; but not Third-Party Subaccounts, will have 180 days to comply with a new Clearing Requirement determination. Category 3 Entities are those with Third-Party Subaccounts, as well as any other entity not eligible to claim an exception under section 2(h)(7) of the CEA, including ERISA plans, and they will have 270 days to comply with a Clearing Requirement determination once it is published in the Federal Register.

The discussion that follows considers the costs and benefits of, and alternatives to, the rule in this adopting release.

D. Statutory Mandate to Consider the Costs and Benefits of the Commission's Action: CEA Section 15(a)

[30] An "Active Fund" is any private fund as defined in section 202(a) of the Investment Advisers Act of 1940, that is not a third-party subaccount and that executes 200 or more swaps per month. The Commission does not intend to use the designation for any purpose beyond this rule.

Section 15(a) of the CEA[31] requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

In this rulemaking the Commission is not imposing clearing requirements, but is exercising its discretion to stagger required clearing implementation according to a particular schedule and subject to the conditions specified in these rules. For purposes of this analysis, the Commission considers the costs and benefits attributable to its choices in this rulemaking—e.g., to stagger the implementation of clearing requirements and to do so in the manner prescribed—against those that would arise absent this Commission action—i.e., if implementation of the Dodd-Frank Act's Clearing Requirement for those swaps that the Commission separately determines to be subject to clearing was not staggered according to the rule's schedule.

For reasons discussed in more detail below, the cost and benefits associated with requiring clearing immediately upon the Clearing Requirement determination for a swap class, or after some longer versus shorter period of delay, are not susceptible to meaningful quantification. As described above, these are not the costs and benefits of implementing Clearing Requirement determinations, but rather the costs and benefits of

[31] 7 U.S.C. 19(a).

implementing them more slowly than would be required in the absence of this rule. The Commission is not aware of any analog to either an immediate or delayed requirement to establish the capability to clear that would produce data that the Commission could use to estimate the difference in costs and benefits between the two. Moreover, any data that might be gleaned from the experiences of an individual market participant establishing a relationship with a futures commission merchant (FCM) during normal market conditions would not reflect the influence of a number of effects that are likely to result from the simultaneous implementation of many market participants in a series of three waves. This coordinated movement creates both costs and benefits that cannot be quantified using data drawn from current market conditions. Notwithstanding these limitations, the Commission identifies and considers the costs and benefits of this rule in qualitative terms.

E. Costs and Benefits of this Rule

Determining whether to implement required clearing immediately upon Commission determination or after some period of delay necessarily involves cost and benefit tradeoffs. On the one hand, delaying required clearing implementation also delays the benefits of clearing of certain swaps, including reduced counterparty risk and increased stability in the financial system. These benefits are substantial, and any delay in their realization represents a cost to the market and the public. On the other hand, requiring implementation immediately or within a very compressed timeframe creates certain costs for industry participants. Reducing these costs—enumerated below—by extending the implementation schedule represents a benefit.

First, to meet pressing timelines, some firms will need to contract additional staff or hire vendors to handle some necessary tasks or projects. Additional staff hired or vendors contracted in order to meet more pressing timelines represent an additional cost for market participants. Moreover, a tightly compressed timeframe raises the likelihood that more firms will be competing to procure services at the same time; this could put firms that conduct fewer swaps at a competitive disadvantage in obtaining those services, making it more difficult for them to meet required timelines.[32] In addition, it could enable service providers to command a pricing premium when compared to times of "normal" or lesser competition for similar services. That premium represents an additional cost when compared to a longer implementation timeline.

Second, if entities are not able to comply with Clearing Requirement determinations by the required date, they may avoid transacting swaps that are required to be cleared until such a time as they are able to comply. In this event, liquidity that otherwise would result from those foregone swaps would be reduced, making the swaps more expensive for market participants taking the other side. Moreover, firms compelled to withdraw from the market pending implementation of required clearing measures will either leave certain positions un-hedged—potentially increasing the firm's own default risk, and therefore the risk to their counterparties and the public. Alternatively, firms compelled to withdraw from the market for a period of time could attempt to approximate their foregone swap hedges using other, likely more expensive, instruments. And to the extent the withdrawing entities are market makers, they will forsake the revenue potential that otherwise would exist for the period of their market absence.

[32] See letter from CIEBA.

Third, firms may have to implement technological solutions, sign contracts, and establish new operational procedures before industry standards have emerged that address new problems effectively. To the extent that this occurs, it is likely to create costs. Firms may have to incur additional costs later to modify their technology platforms and operational procedures further, and to renegotiate contracts—direct costs that a more protracted implementation schedule would have avoided.[33] Moreover, costs created by the adoption of standards that fail to address certain problems, or attributable to undesired competitive dynamics resulting from such standards, may be longstanding.

Given the factors identified above, this rulemaking aims to strike the optimal cost-balance tradeoff amidst the competing concerns. Shorter timelines will tend to push greater numbers of swaps into clearing more quickly, reducing the counterparty and systemic exposures in ways that were intended by the Dodd-Frank Act—a benefit. But, shorter timelines also increase the costs as discussed above. Longer timelines have the opposite effect, decreasing the costs described above, but increasing the amount of time during which counterparty and systemic exposures that would otherwise be mitigated by required clearing persist.

In theory, the optimal tradeoff between the two is the point at which the marginal cost of an additional one-day delay in implementation equals the marginal benefits of the same incremental delay. But it is not possible, at this stage, to determine the marginal costs or benefits of each day of delay. To estimate such values reliably requires data that does not yet exist—i.e., data gleaned in the midst of the transition process. Therefore, neither the Commission nor commenters are able to assert conclusively that any

[33] See e.g., ACLI letter.

particular schedule is more or less advantageous relative to all others that the Commission might have considered. Thus, in the face of these practical limitations, the Commission has relied on qualitative considerations, informed by commenters, to guide the necessary tradeoff determinations.

The Commission, informed by its consideration of comments and alternatives, discussed in the sections above and below, believes that the approach contained in this adopting release is reasonable and appropriate in light of the tradeoffs described above. The schedule established here gives the Commission the opportunity to provide additional time to entities in ways that generally align with: (1) their resources and expertise, and therefore their ability to comply more quickly; and (2) their level of activity in the swap markets, and therefore the possible impact of their swap activities on the stability of the financial system. Entities with the most expertise in, and systems capable to transact, swaps also are likely to be those whose swaps represent a significant portion of all transactions in the swap markets. They are more likely to be able to comply quickly, and the benefits of requiring them to do so are greater than would be the case for less active entities. On the other hand, entities with less system capability and in-house swap expertise may need more time to comply with Clearing Requirement determinations, but it is also likely that their activities represent a smaller proportion of the overall market, and therefore are less likely to create or exacerbate shocks to the financial system.[34] The Commission believes that Category 1 encompasses entities

[34] OCC data demonstrates that among insured U.S. commercial banks, "the five banks with the most derivatives activity hold 96 percent of all derivatives, while the largest 25 banks account for nearly 100% of all contracts." The report is limited to insured U.S. commercial banks, and also includes derivatives that are not swaps. However, swap contracts are included among the derivatives in the report, constituting approximately 63 percent of the total notional value of all derivatives. These statistics suggest that a

likely possessing more advanced systems and expertise, and whose swap activities constitute a significant portion of overall swap market transactions, while Categories 2 and 3 encompass those likely to have relatively less developed infrastructure and whose swap activities constitute a less significant proportion of the market.

The Commission notes that clearing of certain swaps, and in particular interest rate and credit default swaps, has been occurring for some time; by implication, this indicates that the requisite technology, contractual terms, and operational standards among clearinghouses, clearing members, and some clients exist.[35] The Commission also notes that it is likely that the degree to which firms have already implemented such technology, contracts, and operational patterns varies considerably, particularly among potential customers of FCMs, and that the legal, technological, and operational changes that are necessary for less frequent swap market participants may be more substantial. However, given the availability of FCMs (through which market participants may clear swaps) as well as the technology and contractual standards necessary to clear swaps, the Commission believes that a number of firms can reduce the costs associated with meeting compliance timelines by forming necessary FCM relationships and contracts, and

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relatively small number of banks hold the majority of swap positions that could create or contribute to distress in the financial system. Data is insufficient, however, to generalize the conclusions to non-banking institutions. See "OCC's Quarterly Report on Bank Trading and Derivatives Activities: Fourth Quarter 2011" at 11. http://www.occ.treas.gov/topics/capital-markets/financial-markets/trading/derivatives/dq411.pdf.

[35] For example, CME and ICE both began clearing credit default swaps (CDS) in 2009. As of March 2012, ICE had cleared more than $11 trillion notional in CDS, and had 26 clearing members in CDS. CME began clearing interest rate swaps in 2010 and currently has open interest of $210 billion notional and 15 clearing members in interest rate swaps. Moreover, by March of 2010, twenty six of the largest market makers were clearing interest rate derivatives. At that time, ISDA asserted that "In excess of 90% of new dealer-to-dealer volume in Eligible Trades of Interest Rate Derivative products, and total dealer-to-dealer volume in Eligible Trades of Credit Derivative products is now cleared through CCPs." See http://www.newyorkfed.org/newsevents/news/markets/2010/100301_letter.pdf.

implementing the necessary technology, before the Commission begins issuing Clearing Requirement determinations.[36] Nonetheless, the Commission considered these concerns, among other issues, when determining to grant Category 2 and Category 3 Entities an extended 180 and 270 days, respectively, rather than requiring them to comply at the same time as Category 1 Entities.

Moreover, use of the schedule contained in this release is at the Commission's discretion; in situations where the Commission determines that the benefits of delayed implementation do not justify the additional costs of such a delay, the Commission may require immediate compliance with Clearing Requirement determinations. Therefore, in situations where the Commission determines that a swap must be cleared, and further believes that clearing the swap will not necessitate significant changes to market participants' technology, legal arrangements, or operational patterns, the Commission is likely to determine that immediate compliance is warranted. In these cases, the benefits of required clearing will be realized immediately.

The discretionary nature of the schedule contained in the adopting release, however, may create some uncertainty for market participants, and consequently may create some costs as market participants take steps to protect themselves from the impact of such uncertainty. For example, if a market participant believes that the Commission may issue a determination that a particular swap must be cleared, but is not certain whether clearing will be required immediately or according to the schedule contained in

[36] The Commission understands approximately 2.5 months is sufficient for some market participants to enter into a clearing arrangement with an FCM for purposes of clearing swaps. See External Meeting with Blackrock, 4/2/2012. http://www.cftc.gov/LawRegulation/DoddFrankAct/ExternalMeetings/dfmeeting_040212_1463.

this release, that entity may begin developing the capacity to clear such a swap prior to a determination by the Commission in order to reduce the risk that it would be forced to stop trading the swap while it comes into compliance. If that participant's belief that the Commission will require the swap to be cleared is incorrect, the participant will have unnecessarily borne the cost of preparing for such a possibility. The Commission considered this cost, but believes that the notice and comment approach that the Commission will use when issuing Clearing Requirement determinations mitigates it. Each proposed Clearing Requirement determination will be published in the Federal Register and will be available for public comment for a period of at least 30 days; the Commission anticipates clarifying in each proposed Clearing Requirement determination whether compliance will be required immediately upon the final determination or according to the schedule contained in this rule. This approach will provide market participants with notice regarding the expected timeline for compliance, which will mitigate costs associated with uncertainty about compliance timelines.

F. Consideration of Comments and the Costs and Benefits of Alternatives

Commenters propose or otherwise highlight points that suggest alternatives with respect to various aspects of the NPRM.[37] These aspects, as categorized for discussion below, are: (1) phased approach; (2) entity categorization; (3) schedule increments; and (4) schedule discretion.

[37] Other commenters raise issues beyond the scope of this rule—i.e., implementation timing of required clearing—that, consequently, are beyond, and not appropriate for Commission consideration in, this rulemaking. Specifically, some commenters request that the Commission establish a comprehensive schedule for implementation of all rules and requirements pursuant to the Dodd-Frank Act. (See Barnard, MFA). Others request a comprehensive schedule of clearing requirement determinations (See, e.g., CDEU), an issue already addressed by the Dodd-Frank Act and the rule regarding the Process for Review of Swaps for Mandatory Clearing. See section 2(h)(2)(B)(ii) of the CEA; 76 FR 44473.

Phased Approach

A number of commenters express support generally for additional time to comply with Clearing Requirement determinations and for a phased approach that distinguishes between various types of entities.[38] Commenters note that the additional clarity provided by the schedule will encourage industry participants to commit resources to overcoming structural and economic barriers that prevent widespread clearing.[39] Some commenters, however, maintain that the phased approach used to implement clearing requirement determinations should not be applied to exchange trade requirements.[40] The AIMA believes that effective required clearing will enable execution of swaps on SEFs and DCMs and that linking the trading and clearing compliance schedules could delay the transition into central clearing. In response to these comments, the Commission has decided to limit the scope of this rule to Clearing Requirement determinations, to retain the phased approach to required clearing, and to address implementation of trade execution in a separate rule.

Some commenters note that a phased approach could complicate implementation for large investor advisor firms that may have multiple funds in separate categories. Specifically, AII expresses concern that it may be difficult for institutional advisers to execute block trades for multiple clients during the implementation period because they will have to consider whether each client must comply with the Clearing Requirement. Nevertheless, AII recommends retaining the phased approach with at least 18 months for

[38] See letters from Encana, Vanguard, ICI, FSR, MFA, FIA/ISDA/SIFMA, AII, MarkitSERV, and AIMA.

[39] See MFA letter.

[40] See letters from AIMA and MFA.

entities to comply. The Commission recognizes that such complexities exist and could introduce certain costs for large investor adviser firms. However, it is not clear that delaying the implementation period would alleviate this concern, although prolonging the implementation period likely would exacerbate the issue by extending the time during which such concerns are relevant. Moreover, the Commission notes that the benefits of required clearing are substantial and that further delays create costs borne by market participants and the public. In these circumstances, the Commission considers the latter consideration most compelling and, accordingly, has determined not to delay implementation beyond what is set forth in the schedule in the adopting release.

Finally, relative to the alternative of immediate implementation following a Commission Clearing Requirement determination—the result in the absence of this rule—the Commission believes that the phased approach reflected in this adopting release is superior. The immediate implementation alternative would not mitigate the costs, enumerated above, to market participants and the public. In contrast, while delaying implementation also entails a different set of costs, also discussed above, the Commission has carefully tailored the rule's phased approach to contain and dampen them.

Entity Categorization

Commenters generally agree that some buy-side representation in Category 1 is valuable in order to ensure that buy-side interests are represented as technological and legal standards begin to form,[41] though commenters express varied views about whether Active Funds should play that role, and what entities should be included in that group.

[41] See AIMA letter.

Some commenters state their belief that transaction volume is an appropriate proxy for a firm's level of expertise in conducting swaps and, therefore, is a useful criterion for identifying the buy-side entities that are best equipped to make the transition as part of Category 1.[42] Some express concern, however, that as defined in the NPRM, the term "Active Fund" could be over-inclusive and recommend raising the threshold number of swaps or excluding swaps that are hedges or have a notional value below $10 million.[43]

The Commission's intent in selecting Active Funds to participate in Category 1 is to identify those market participants that are larger and have significant experience in the swap markets. To ensure that the rule effectively selects for these entities, and in response to commenters, the Commission has raised the threshold number of swaps from a trailing average of 20 swaps per month over the previous twelve months, to a trailing average of 200 swaps per month over the previous twelve months. The Commission, however, believes that further criteria restricting the swaps that are included against that count would create incremental administrative and operational costs that do not justify the resulting benefit, and therefore has not placed further restrictions on the types of swaps that count against the threshold. However, per commenters' request for clarification, the Commission is clarifying that the average monthly threshold of swaps applies to new swaps that the entity enters into, and it does not apply to novations, amendments, or partial tear-ups.

ACLI maintains that there is diversity among buy-side participants in their use of swaps, and expresses concern that Active Funds may not be able to effectively represent

[42] See letters from Barnard and AIMA.

[43] See letters from AII and CDEU.

diverse buy-side interests, and those of insurance companies in particular. ACLI, however, does not describe or quantify specific costs that it believes would result from this circumstance.[44] The Commission acknowledges that buy-side market participants are diverse and may have specific needs reflecting concerns or interests unique to individual industries or even individual entities. However, the Commission also notes that the fact of certain differences among firms does not exclude the possibility of remaining similarities. Further, it believes that realizing the benefits provided by some buy-side representation in Category 1 is preferable to a scenario in which these benefits are foregone by removing Active Funds from Category 1 for required clearing implementation. Moreover, in the absence of any input as to how dissimilarities may specifically impact the compliance implementation process, the apparent solution to ACLI's concern would be to include insurance companies in Category 1 to assure representation of their interests earlier in the implementation process. While any Category 2 Entity or any other entity may elect to comply sooner than the schedule requires (and are encouraged by the Commission to do so), the Commission finds no basis to believe that the benefits of requiring all insurance companies to participate in Category 1 warrant the additional costs that such an approach would create for them.

MFA expresses concern that questions related to the term "Active Fund" could create an additional burden for fund operations and Commission staff, and proposed that all private funds be placed in Category 2 in order to eliminate this burden.[45] MFA, however, does not specify what these questions are, nor the cost to funds associated with

[44] See ACLI letter.

[45] See MFA letter.

addressing them. In the absence of more specific information about the nature of the potential questions and their associated costs, the Commission has insufficient basis to conclude that costs to clarify Active Fund issues—either for fund operators or itself—are likely to be significant. Accordingly, it believes that the benefits of early-stage, buy-side representation warrant retention of the Category 1 Active-Fund component.

Some commenters express concern about the definition of the term Third-Party Subaccounts. They maintain that the Third-Party Subaccount category should include any managed accounts, regardless of the level of authority granted in the advisory agreement to enter into trading agreements, on grounds that the operational and contractual challenges for moving swaps related to these accounts into clearing will be much the same regardless of whether the accounts' investment management agreements have "specific approval" requirements.[46] Similarly, some commenters advocate in favor of including all ERISA plans in Category 3 given their expectations that (1) Category 2 entities will bear more "start-up" costs related to required clearing than those in Category 3, and (2) putting some ERISA plans in Category 2 and others in Category 3 will make overlays more difficult and costly.[47] Conversely, AIMA specifically states that making all funds Category 3 Entities is not a suitable approach because it would eliminate buy-side representation during the early stages of implementation, and, consequently, urges the Commission not to adopt this approach.[48]

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[46] See e.g., letters from ICI and AII.

[47] See CIEBA letter.

[48] See AIMA letter.

Furthermore, AIMA and FSR asserted that some Third-Party Subaccounts may be "private funds" as defined in the Investment Advisers Act of 1940 that would otherwise qualify as Active Funds; AIMA expresses concern that allowing such funds 270 days to comply with clearing requirements could provide them a competitive advantage relative to other Active Funds that are not Third-Party Subaccounts for the period of time between the compliance dates for Categories 1 and 3. To level this playing field, AIMA proposes placing all Active Funds in Category 1, regardless of whether the funds also meet the criteria for a Third-Party Subaccount. In support of this proposition, AIMA opines that large institutional managers of large numbers of Third-Party Subaccounts are likely to have sufficient resources to make the transition within the 90 days required of Category 1 Entities.

The Commission recognizes that some managed funds that do not require third party sign-off for clearing agreements, nevertheless, may choose to involve their clients in negotiation of relevant documents, and that some costs may result from placing some managed funds and ERISA plans in Category 2 and others in Category 3. After considering the alternatives posed by commenters, the Commission has modified the definition of Third-Party Subaccount to include managed accounts for which the investment manager is responsible for clearing documentation, regardless of whether the investment manager has explicit execution authority. In addition, the Commission has determined not to include ERISA plans in Category 2. The Commission has made these changes despite the fact that commenters do not attempt to quantify the costs associated with these provisions, nor do they recognize that such costs must be considered against the costs of further delaying required clearing implementation by a number of managed

funds and ERISA plans. A fundamental premise of the Dodd-Frank Act is that central clearing minimizes risk to counterparties and the financial system as a whole; therefore, further delaying implementation of one or more groups of market participants creates costs associated with prolonged exposure of the financial system to a greater number of un-cleared swaps. Nonetheless, the Commission believes it appropriate to permit certain market participants an additional 90 days to come into compliance with the clearing requirement based on the comments received.

Schedule Increments

Some commenters express the opinion that 90, 180, and 270 days is sufficient for Category 1, 2, and 3 Entities, respectively, to comply with Clearing Requirement determinations.[49] Several other commenters, however, expressed concern that the additional time provided in this rule may not be sufficient for some entities to comply.[50] In that vein, commenters state that the schedules may not be sufficient for contract negotiations to be completed,[51] that pressing timelines could undermine the ability of some entities to negotiate effectively,[52] and that rapid compliance may lead to the creation of industry standards that are not fair or prudent.[53] Some commenters also

[49] See e.g., letters from Better Markets and MFA. MFA qualifies its support, stating that certain additional rules should be adopted prior to the schedule becoming effective, and also requests changes to the entities included in each category, but still generally supports the 90, 180, and 270 day implementation schedule.

[50] See e.g., letters from AII, CIEBA, ICI, FIA/ISDA/SIFMA, and FSR.

[51] See e.g., ACLI letter.

[52] See letters from ACLI, AII, and CIEBA.

[53] See letters from ACLI and ICI.

express concern that entities in Categories 2 and 3 may not be able to find vendors able to provide sufficient support to meet the deadlines effectively.[54]

It is impossible to quantify the costs and benefits of one particular schedule phase-in increment relative to another—e.g., 90 days to comply versus 110—and the permutations of such an exercise would be endless, even if possible. Similarly, as discussed above, whether the schedule included in this adopting release mitigates costs to a greater degree than other increments the Commission might have adopted as an alternative to immediate implementation of required clearing (the result in the absence of this rule) is also a question that cannot be resolved with precision. In light of these limitations, however, the Commission has drawn upon its historical experience monitoring clearing, as well as its consideration of the qualitative feedback offered by market participants, in determining to incorporate the 90-, 180-, and 270-day benchmark features within the schedule adopted in this release. In so doing, the Commission believes that it has selected a reasonable schedule that is appropriate and well-suited to mitigate compliance pressures for market participants, and fairly accommodate the various competing interests involved.

As is stated above, the Commission recognizes that extending the compliance schedule for one or more entities will reduce compliance costs for market participants in a number of different ways, but will also increase the amount of time during which market participants and the public do not benefit from the protections provided by mandatory clearing.

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[54] See letters from ACLI, CDEU, CIEBA, COPE, and EEI. COPE and EEI specifically requested that the Commission determine whether "off the shelf" software is available to meet the needs of entities that do not yet have necessary technology. Further conversation clarified that both were concerned about technologies that extend beyond those directly related to Clearing Requirements established by the Act.

Scheduling Discretion

Some commenters support the Commission's retention of discretion to override the schedule in this release to require immediate clearing when it believes that the benefits do not justify the associated costs.[55] These commenters note that over time market participants will gain experience to enable swifter compliance with later Clearing Requirement determinations, and maintain that, over time, the compliance schedules will not be warranted for Clearing Requirement determinations for new types, groups, or categories of swaps within an asset class that are already subject to a prior Clearing Requirement.[56] Other commenters, however, support application of the schedule to all Clearing Requirement determinations in order to reduce uncertainty and facilitate orderly transitions to compliance.[57]

As discussed below, the Commission believes that the challenges of compliance are likely to vary depending on whether previous Clearing Requirement determinations have been made for other swaps in the same class, how long previous Clearing Requirement determinations for swaps in that class have been in place, the similarities between the swaps addressed by a determination and swaps subject to previous determinations, and a number of other factors. Therefore, the Commission believes that the tradeoff between the costs and benefits of more rapid compliance will vary as well. Where Clearing Requirement determinations pertain to swaps that have important points of similarity with swaps already required to be cleared, it is likely that the costs

[55] See letters from Barnard and MFA.

[56] See letters from Barnard and MFA.

[57] See letters from FHLB and ICI.

associated with more rapid compliance will be significantly less, and therefore the balance will shift in favor of a shorter compliance deadline than would be allowed under the schedule contained in this rule. Also, by including the applicable compliance schedule within its public notifications of a proposed Clearing Requirement determination, the Commission will mitigate uncertainty costs that could result.

G. Consideration of Section 15(a) Factors

1) Protection of Market Participants and the Public

Category 1 includes, among others, SDs as well as MSPs and Active Funds. If SDs were not able to comply immediately with a Clearing Requirement determination, and were not given additional time to comply, they could choose to withdraw from the market as they work toward compliance. Such withdrawal would create lost opportunities for them as they fail to capture business that they would have otherwise conducted during that period. If MSPs or Active Funds choose to withdraw from the market while they work to come into compliance, it could become more costly for them to either effectively create or hedge certain exposures, which could also prompt them to leave certain risks un-hedged that they would otherwise mitigate through the use of swaps. By giving Category 1 Entities an additional 90 days to comply with Clearing Requirement determinations, the schedule contained in this adopting release reduces the likelihood of these entities withdrawing from the swap markets while they work toward compliance; this, in turn, reduces the probability that these Category 1 Entities will bear the potential costs of un-hedged risk exposure.

Moreover, the Commission believes that SDs are an important source of liquidity for swap market participants. If SDs withdraw from the market while they work toward

compliance, it could negatively impact swap liquidity, increasing costs for market participants forced to hedge certain risks through less efficient means (or not at all) for a period of time. The costs of not hedging certain risks would be borne not only by the firms that choose such an approach, but by the public in the form of increased counterparty risk throughout the financial system. Again, by providing additional time for SDs to comply with Clearing Requirement determinations, the schedule in the adopting release facilitates an orderly transition and reduces the likelihood that the costs associated with SDs withdrawing from the market for a period of time would materialize. The Commission considered this benefit in light of the cost associated with delayed compliance among Category 1 Entities and believes that an appropriate balance has been struck.

The Commission also anticipates that the staggered compliance schedule contained in this rule will, to some extent, enable Category 2 and 3 Entities to adopt technological, legal, and operational standards developed by Category 1 Entities. To the extent that this occurs, it will reduce the number of entities that are working in parallel to develop solutions to the same problems by allowing Category 2 and 3 Entities some time to wait for Category 1 Entities and vendors to develop viable solutions to technological, legal, and operational challenges. Some of those solutions are likely to be proprietary, while others will likely relate to non-proprietary standards that must be shared in order to be effective. Both types of advances can reduce costs for Category 2 and 3 Entities. In the case of non-proprietary standards, Category 2 and 3 entities will benefit from the opportunity to adopt them without having to invest in their development. In the case of proprietary solutions, some of them are likely to be owned by vendors marketing them to

multiple market participants, thereby spreading the development costs among their clients. Each of these consequences is likely to reduce overall development costs for the industry, and development costs for Category 2 and 3 Entities, in particular.[58]

In weighing the tradeoff between shorter versus longer compliance timelines, the Commission believes Category 2 Entities are likely to be less well-resourced and less active in these markets. Therefore the dynamic between more or less rapid compliance tips in favor of providing additional time for these entities. As stated above, by providing 180 days, it becomes more likely that Category 2 Entities will be able to draw from lessons learned and standards established by Category 1 Entities. It also increases the likelihood that where Category 2 Entities will depend on vendors for help developing and implementing necessary technology, legal agreements, and operational patterns, they will not have to compete as directly with Category 1 Entities for those resources.

The Commission believes that entities with Third-Party Subaccounts have an additional challenge of transitioning hundreds (or in some cases, thousands) of subaccounts into compliance with Clearing Requirement determinations, which may require formalizing new agreements with each of their customers, and educating their customers about how the Clearing Requirement will impact costs and operations. In the Commission's view, this additional challenge justifies additional time for compliance beyond what is allowed for Category 2 Entities.[59]

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[58] As indicated in the NPRM, to the extent that Category 1 Entities bear a larger portion of the industry wide "start-up" or development costs, the Commission believes this is appropriate since they are likely to be among the most active participants in these markets.

[59] As stated in the NPRM, Category 2 and 3 Entities that want to come into compliance sooner than the 180 and 270 day deadlines are allowed, and encouraged, to do so.

As described above, the Commission recognizes that delaying implementation creates some additional costs in the form of delayed protections that central clearing of swaps would otherwise provide—standardized and reduced counterparty risk for swaps that are required to be cleared, and associated reductions in the overall level of systemic risk. However, the Commission believes that this approach appropriately balances the tradeoff by requiring firms that are likely to be the most active in these markets to comply first and allowing additional time for those whose positions are less likely to pose significant risk to the financial system as a whole.

2) Efficiency, competitiveness, and financial integrity of futures markets

As suggested above, Category 1 Entities are likely to establish technological, legal, and operational standards that will influence or be adopted by Category 2 and 3 Entities. This will (1) serve to reduce development costs that Category 2 and 3 Entities otherwise would face, (2) focus responsibility for shaping new platforms and standards on those firms that possess greater cleared swap experience, and (3) support the likelihood that new platforms and standards will reflect current best practices. Each of these elements promotes the efficiency and integrity of the markets. Moreover, by reducing the number of entities necessarily working in parallel to develop such standards, and allowing Category 2 and 3 Entities to learn from and build on the solutions developed by Category 1 Entities, the phased schedule contained in this adopting release holds the potential to foster compatibility and interoperability, which reduces the cost and complexity of interconnectedness.

The phased schedule as adopted also will promote an implementation plan in which similar entities (i.e., those that usually compete with one another) generally have

the same compliance timelines, thereby protecting competition during the transition period. One commenter states, "A phased approach to compliance will allow the Commission to balance its goal of obtaining adequate representation at each stage of the regulatory roll-out with the goal of avoiding anti-competitive concerns."[60]

That said, however, the Commission also has to balance the goal of maintaining a level playing field with other priorities. In particular, the Commission deems it important to ensure representation of both buy and sell side firms in the earliest stages of compliance. Moreover, the Commission believes that, in certain circumstances, variance in compliance burden among competitors warrants placing them in different implementation categories. Some competitive consequences may result from the need to balance these various priorities. The Commission believes, however, that it has built sufficient flexibility into the phased schedule to mitigate such consequences; specifically, the schedule preserves entities' ability to respond to competitive incentives to move into clearing voluntarily prior to the date required by the compliance schedule. The Commission believes that providing flexibility to allow expression of competitive market incentives is preferable to the alternative of imposing a more compressed compliance schedule for purposes of maintaining a level playing field. As discussed above, a shorter schedule could also increase the likelihood that industry standards established during the implementation period could create and perpetuate undesirable competitive dynamics. In sum, the Commission anticipates that any temporary impacts on competitive dynamics created by the phased implementation approach it is adopting are likely to be less costly than an approach that increases the likelihood of sustained competitive disparities, and

[60] See ICI letter.

therefore has chosen not to shorten the compliance schedule as a remedy to address the risk of competitive advantages that may be conferred on market participants that have later compliance dates.

As discussed above, for the 90-, 180-, and 270-day periods that Clearing Requirements are delayed, the markets are exposed to the risks that the Clearing Requirements would mitigate. However, the Commission has considered this cost for the limited delay durations prescribed in light of the benefits—reduced implementation costs, greater degrees of compatibility and interoperability, and lessened risk of market disturbances from the withdrawal of entities that are not able to comply immediately—and considers the tradeoff reflected in the rules warranted.

3) Price discovery

Neither the Commission nor commenters have identified consequences for price discovery that are expected to result from this rule.

4) Sound risk management practices

An orderly transition for swaps subject to a Clearing Requirement determination promotes sounder risk management practices, particularly during the transition period. As mentioned above, in the absence of the schedule provided in this rule, some entities might exit swap markets while taking steps to come into compliance. This result could reduce liquidity, particularly if the withdrawing entities are SDs. Reduced liquidity likely would increase the cost of using swaps to manage risk by increasing spreads, and make it more difficult for entities to enter and exit positions in a timely manner. It could also prompt some entities to maintain exposures that they would otherwise use swaps to mitigate, which would elevate the risk profile of those entities and the level of risk that

their counterparties bear as a consequence. By providing a timetable for orderly transition, this rule encourages continued participation in the swap markets and use of swaps for risk mitigation purposes during the transition.

Clearing Requirement delay does prolong existing costs associated with not having counterparty credit risk monitored and managed effectively by a DCO. More prompt implementation of Clearing Requirements would have the benefit of preventing losses from accumulating over time through the settlement of variation margin between a DCO's clearing members each day. The settlement of variation margin each day (and in some cases, multiple times per day) reduces the size of exposures a clearinghouse faces should one of its counterparties default, and the mechanisms that a clearinghouse has to ensure its own solvency reduce the probability that it would default on obligations to clearing members. Moreover, more prompt implementation also promotes the use of initial margin as a performance bond against potential future losses such that if a party fails to meet its obligation to pay variation margin, resulting in a default, the DCO may use the defaulting party's initial margin to cover most or all of any loss based on the need to replace the open position. The Commission believes, however, that (1) it has tailored the rule to limit the degree, and thereby these costs attributable to, clearing implementation delay and (2) the benefits afforded by the schedule's operation when the Commission elects to use it warrant the costs of the tailored implementation delay.

5) Other public interest considerations

The schedule allows market participants to comply with the requirements of the Dodd-Frank Act and provides a sound basis for achieving the overarching Dodd-Frank Act goals of reducing counterparty risk and promoting stability of the financial system.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.[61] As stated in the NPRM, the subject of this rulemaking provides a compliance schedule for a new statutory requirement, section 2(h)(1)(A) of the CEA, and does not itself impose significant new regulatory requirements.[62] Accordingly, the Chairman, on behalf of the Commission, certified pursuant to 5 U.S.C. 605(b) that the proposed rule would not have a significant economic impact on a substantial number of small entities. The Commission then invited public comment on this determination.

FSR comments that the NPRM failed to evaluate the impact of the proposed compliance schedule for the Clearing Requirement on a substantial number of small entities. FSR argued that small entities may have to bear a more significant burden than larger entities in establishing clearing arrangements with FCMs because larger entities will be able to enter into such arrangements first.

In response, the Commission points out that the compliance schedule for the Clearing Requirement will affect only eligible contract participants (ECPs). Pursuant to section 2(e) of the CEA, only ECPs may enter into swaps, unless the swap is listed on a DCM. The Clearing Requirement will affect only ECPs because all persons that are not ECPs are required to execute their swaps on a DCM, and all contracts executed on a

[61] 5 U.S.C. 601 et seq.

[62] 76 FR 58192-58193 (Sept. 20, 2011).

DCM must be cleared by a DCO, as required by statute and regulation; not by operation of any Clearing Requirement.

The Commission has previously determined that ECPs are not small entities for purposes of the RFA.[63] However, in their comment letter, the Joint Associations assert that certain members of the National Rural Electric Cooperative Association (NRECA) may both be ECPs under the CEA and small businesses under the RFA. These members of NRECA, as the Commission understands, have been determined to be small entities by the Small Business Administration (SBA) because they are "primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and [their] total electric output for the preceding fiscal year did not exceed 4 million megawatt hours."[64] Although the Joint Associations do not provide details on whether or how the NRECA members that have been determined to be small entities use the types of swaps that will be subject to the Clearing Requirement, the Joint Associations do state that NRECA members "engage in swaps to hedge commercial risk."[65] Because the NRECA members that have been determined to be small entities would be using swaps to hedge commercial risk, the Commission expects that they would be able to use the end-user exception from the Clearing Requirement and therefore would not be affected to any significant extent by the Clearing Requirement.

Thus, because nearly all of the ECPs that may be subject to the Clearing Requirement are not small entities, and because the few ECPs that have been determined

[63] See 66 F.R. 20740, 20743 (Apr. 25, 2001).

[64] Small Business Administration, Table of Small Business Size Standards, Nov. 5, 2010.

[65] See Joint Associations' comment letter, at 2. The letter also suggests that NRECA members are not financial entities. See id., at note 5, and at 5 (the associations' members "are not financial companies").

by the SBA to be small entities are unlikely to be subject to the Clearing Requirement, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the rule herein creating the compliance schedule for the Clearing Requirement will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)[66] imposes certain requirements on federal agencies (including the Commission) in connection with conducting or sponsoring any collection of information as defined by the PRA. As stated in the NPRM, this rulemaking will not require a new collection of information from any persons or entities.[67]

V. List of Subjects

List of Subjects in 17 CFR Part 50

Business and industry, Clearing, Swaps.

In consideration of the foregoing, and pursuant to the authority in the Commodity Exchange Act, as amended, and in particular section 2(h) of the Act, the Commission hereby adopts an amendment to Chapter I of Title 17 of the Code of Federal Regulation by adding a new part 50 as follows:

PART 50 – CLEARING REQUIREMENT

Authority: 7 U.S.C. 2 as amended by Pub. L. 111-203, 124 Stat. 1376.

§ 50.25 Clearing requirement compliance schedule.

[66] 44 U.S.C. 3507(d).

[67] 76 FR 58186, 58193 (Sept. 20, 2011).

(a) Definitions. For the purposes of this paragraph:

Active Fund means any private fund as defined in section 202(a) of the Investment Advisers Act of 1940, that is not a third-party subaccount and that executes 200 or more swaps per month based on a monthly average over the 12 months preceding the Commission issuing a clearing requirement determination under section 2(h)(2) of the Act.

Category 1 Entity means a swap dealer, a security-based swap dealer; a major swap participant; a major security-based swap participant; or an active fund.

Category 2 Entity means a commodity pool; a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 other than an active fund; or a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956, provided that, in each case, the entity is not a third-party subaccount.

Third-party Subaccount means an account that is managed by an investment manager that is independent of and unaffiliated with the account's beneficial owner or sponsor, and is responsible for the documentation necessary for the account's beneficial owner to clear swaps.

(b) Upon issuing a clearing requirement determination under section 2(h)(2) of the Act, the Commission may determine, based on the group, category, type, or class of swaps subject to such determination, that the following schedule for compliance with the requirements of section 2(h)(1)(A) of the Act shall apply:

(1) A swap between a Category 1 Entity and another Category 1 Entity, or any other entity that desires to clear the transaction, must comply with the requirements of section 2(h)(1)(A) of the Act no later than ninety (90) days from the date of publication of such clearing requirement determination in the Federal Register.

(2) A swap between a Category 2 Entity and a Category 1 Entity, another Category 2 Entity, or any other entity that desires to clear the transaction, must comply with the requirements of section 2(h)(1)(A) of the Act no later than one hundred and eighty (180) days from the date of publication of such clearing requirement determination in the Federal Register.

(3) All other swaps for which neither of the parties to the swap is eligible to claim the exception from the clearing requirement set forth in section 2(h)(7) of the Act and § 39.6, must comply with the requirements of section 2(h)(1)(A) of the Act no later than two hundred and seventy (270) days from the date of publication of such clearing requirement determination in the Federal Register.

(c) Nothing in this rule shall be construed to prohibit any person from voluntarily complying with the requirements of section 2(h)(1)(A) of the Act sooner than the implementation schedule provided under paragraph (b).

Issued in Washington, DC, on July 24, 2012, by the Commission.

Sauntia Warfield,

Assistant Secretary of the Commission.

Appendices to Swap Transaction Compliance and Implementation Schedule: Clearing Requirement under Section 2(h) of the CEA —Commission Voting Summary and Statements of Commissioners

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1- Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Sommers, Chilton, O'Malia and Wetjen voted in the affirmative; no Commissioner voted in the negative.

Appendix 1- Statement of Chairman Gary Gensler

I support the final rule to establish a schedule to phase in compliance with the clearing requirement provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The rule gives market participants an adequate amount of time to comply and helps facilitate an orderly transition to the new clearing requirements for the swaps market.

The rule provides greater clarity to market participants regarding the timeframe for bringing their swaps into compliance with the clearing requirement.

[FR Doc. 2012-18383 Filed 07/27/2012 at 8:45 am; Publication Date: 07/30/2012]